TAX NEWS

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TIRARD, NAUDIN

International Tax Newsletter

LEADER

Following the adoption of the second amendment to the Finance Law of 2012 (in August 2012), which had already significantly increased the tax burden for French resident and non resident individuals (e.g. by applying French social contributions to the property income of non residents, restoring the former wealth tax rates and increasing gift and inheritance taxes, etc), the French Parliament has passed the third amendment to the Finance Law of 2012 and the Finance Law of 2013, giving rise to new adverse tax consequences for individuals.

As promised by the new Socialist government, additional measures are introduced with the aim of increasing taxes on wealthy individuals. Although the impact of these Laws has been tempered somewhat by the French Constitutional Court (*Conseil constitutionnel*) which ruled certain measures unconstitutional, progressive wealth tax rates are reinstated, a new marginal rate for income tax is created, and the income of individuals from capital (dividends, interest, capital gains on the sale of shares) becomes, as a general rule, subject to the standard progressive rates of income tax.

Several measures affecting corporate taxation are also introduced. They include an increase in the taxation of capital gains on the sale of participations, a change in the rules governing the taxation of companies' unrealized gains upon the transfer of their registered office or establishment outside France and a further restriction to the deductibility of financial expenses.

WEALTH TAX AND INCOME TAX RATES

INCOME TAX RATES

Introduction of a new 45% income tax bracket

The Finance Law of 2013 introduces a new 45% tax rate which applies to an individual's 2012 taxable income in excess of €150,000.

On top of this marginal rate, resident and non-resident individuals are also subject to an additional contribution on high incomes at the rate of 3% for the band of income between €250,000 and €500,000 for single taxpayers (between €500,000 and €1,000,000 for couples subject to joint taxation), and at the rate of 4% for the band of income over €500,000 for single taxpayers (over €1,000,000 for couples subject to joint taxation) (See our Tax Letter of January 2012).

Censure by the Constitutional Court of the provision introducing a global 75% tax rate on very high incomes

The widely reported provision included in the draft Finance Bill for 2013 aimed at introducing a temporary contribution of 18% which would have applied to the band of a French resident individual's taxable income over €1,000,000, with the purpose of reaching an overall tax rate of 75% (including the marginal income tax rate, social contributions and the temporary contribution on high incomes) was rejected by the French Constitutional Court as being unconstitutional.

The French government has, however, announced that it is already contemplating the proposal of a new Law in this respect by mid-2013, which it expects to comply with the Constitutional Court's requirements.

WEALTH TAX RATES

The Finance Law of 2013 reintroduces progressive wealth tax rates. The wealth tax payable for 2013 will be determined by applying to an individual's taxable assets in excess of €800,000 a sliding scale varying from 0.50% to 1.50% (for the band of assets of which the value exceeds €10,000,000).

The current wealth tax threshold is maintained, although slightly increased to €1,310,000. Taxpayers whose net assets are worth between €1,310,000 and €1,410,000 will, however, be entitled to a specific relief in order to mitigate the threshold effect.

A cap is reintroduced, with the effect of limiting the overall amount of taxes (wealth tax plus income tax and social contributions) paid on income received during a fiscal year to 75% of the net income received during that fiscal year.

FRENCH RESIDENTS' DIVIDENDS AND INTEREST

For French residents, the 21% withholding applicable to dividends and 24% withholding applicable to interest are no longer final as from 1st January 2013. Dividends and interest received by French residents are now subject in any case to the standard progressive rates of income tax (plus social contributions at the current rate of 15.5%).

The provision under which such measures would have applied retroactively as from 1st January 2012 was rejected by the French Constitutional Court.

Therefore dividends and interest received by French resident individuals in 2012 which have already been subject to the withholding remain taxable at the 24% or 21% flat rate, plus 15.5% social contributions (of which the deductible fraction has been reduced from 5.8% to 5.1%).

TRANSFER OF OFFICE OR ESTABLISHMENT OUTSIDE FRANCE

The transfer by a company of its registered office or establishment outside France triggers, in principle, a charge to corporation tax on the company's unrealised or latent capital gains, unless the transfer is made to an EU Member State and is not accompanied by a transfer of the company's assets.

The third amendment to the Finance Law of 2012 introduces a measure providing that in the event of a transfer of the office or establishment to an EU Member State or Norway, accompanied by the transfer of all or part of the related assets, corporation tax on the unrealised or latent capital gains must be paid within two months of the transfer, either for the whole amount of tax or, upon request, for 1/5th of the amount with payment of the remainder by equal 1/5th instalments for the following four years.

The corporation tax liability will in any event become fully due if, within 5 years of the transfer, the company's assets are transferred to a State other than an EU Member State or Norway, the company is dissolved, or the annual payment deadlines are not met.

LONG-TERM CAPITAL GAINS ON THE SALE OF PARTICIPATIONS

Under the capital gains regime applicable to companies, capital gains realised on the sale of a participation held for more than two years were until now exempt from corporation tax except on a fixed fraction amounting to 10% of the net capital gain. The Finance Law of 2013 provides that, for the fiscal years ending 31st December 2012 and subsequently, the taxable fraction of the gain will increase to 12% and will be assessed on the gross amount of the capital gain.

CAPITAL GAINS OF INDIVIDUALS

CAPITAL GAINS ON THE SALE OF SHARES AND SECURITIES

New principle of taxation at the progressive rates of income tax

The Finance Bill for 2013 abolishes retroactively, as from 1st January 2012, the 19% rate which applied to French residents' capital gains on the sale of shares and securities. Such gains are now subject to the standard progressive rates of income tax (including the new 45% income tax bracket for taxable income over €150,000).

However, for the purpose of determining the taxable net gain, yearly allowances will apply as from the second year of ownership, at the following rates: 5% if the shares are held for a period from two to four years; 10% if the shares are held for a period from four to seven years; and an additional allowance of 5% per year applicable as from the 7th year of ownership until the 12th year.

The first 5% allowance will therefore apply as from 2015, with a possible 40% maximum allowance as from 2025.

However, for French resident individuals, the social contributions due on such capital gains (at the current rate of 15.5%) will be assessed on the whole gain without taking into account the allowance system.

In order to mitigate the potential burden of this new tax regime in its first years of application, a temporary measure is introduced with the aim of capping capital gains realised in 2012, 2013 and 2014 to a certain fraction of their amount, depending on the length of ownership of the shares transferred.

Exit tax

As a consequence of the new tax regime, the exit tax applicable to the unrealised gains of an individual who transfers his tax residence outside France as from 28th September 2012 will be equal to the difference between (i) the amount of income tax at progressive rates calculated on the individual's worldwide income including unrealised capital gains and (ii) the amount of income tax calculated on his worldwide income except unrealised capital gains.

Substantial holdings of non-residents

For non-resident individuals, the taxation of capital gains deriving from the sale of all or part of a participation exceeding (together with the participations of their spouse, ascendants and descendants) 25% of the capital in a French company liable to corporation tax, at any time during the five years preceding the sale, is increased from 19% to 45% as from 1st January 2013.

CAPITAL GAINS ON THE SALE OF REAL PROPERTY

Additional 20% temporary allowance for 2013

For French residents, capital gains on the sale of French property remain subject to the current 19% flat rate (plus social contributions at the current rate of 15.5%). However, the Finance Law of 2013 provides that such gains occurring in 2013 will benefit from an additional 20% temporary relief.

For sales of real estate made on or after 1st February 2012, a yearly allowance already applies as from the 6th year of ownership (at progressive rates of 2%, 4% or 8% depending on the length of ownership), with a consequent full exemption for properties held for more than 30 years.

The additional 20% relief introduced by the Finance Law for 2013 will apply to the net capital gain determined after applying the yearly allowance system.

New tax on capital gains on the sale of real property

The third amendment to the Finance Law of 2012 introduces, with effect from 1st January 2013, a new tax assessed on capital gains exceeding €50,000 realised upon the sale of real property by both French residents and non residents. This new tax will apply to the whole amount of the capital gain, at a flat rate varying from 2% to 6% (for capital gains exceeding €250,000).

STOCK OPTIONS

The Finance Law of 2013 abolishes the current flat rates applicable to capital gains realised upon the purchase of stock-options or bonus shares, at 18%, 30% or 41% depending on the length of time between the attribution of the shares and the purchase option.

For bonus shares or stock-options attributed since 28th September 2012, the capital gain realised when the purchase option is exercised is now subject to the standard progressive rates of income tax.

SHARE CONTRIBUTIONS FOLLOWED BY IMMEDIATE DISPOSAL

The third amendment to the Finance Law of 2012 abolishes the tax deferral regime currently applicable to the contribution of shares to a company controlled by the contributor. Under this regime, the contribution was regarded as an intermediary transaction which did not trigger taxation.

The new measure now provides that in such a case, a capital gain is effectively realised upon the contribution of shares and that the gain will either be immediately taxable or benefit from a payment deferral. The payment deferral applies when the company receiving the contributed shares (i) is established in an EU Member State or in a State which has entered into a tax treaty with France and (ii) does not transfer the contributed shares within three years of the contribution, or reinvests at least 50% of the proceeds of the share transfer within two years in a business which is industrial, commercial, professional, artisanal, agricultural or financial (with certain exceptions). The payment deferral will end when the contributor transfers the shares received in consideration of his contribution, or transfers his tax residence outside France. However, a gift of shares received in consideration of the contribution will not bring the payment deferral to an end.

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